

# **AGENDA ITEM 1**

**NO BACKUP  
FOR THIS SECTION**

## **AGENDA ITEM 2**

**CITY OF HOLLYWOOD EMPLOYEES' RETIREMENT FUND**  
**TRUSTEE/STAFF LIST**  
(Updated March 2016)

**Board of Trustees (seven):**

Phyllis Shaw, MBA, Chair  
Senior Accountant  
City of Hollywood  
Department of Public Utilities  
1621 N. 14<sup>th</sup> Avenue  
Hollywood, FL 33020  
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Term: 3/1/2015 – 2/28/2018

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Term: 7/1/2014 – 6/30/2017\*

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Term: None

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Term: 3/1/2016 – 2/28/2019

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Term: 7/1/2014 – 6/30/2017\*

\* Per City of Hollywood Ordinance O-2009-34, the term ends on the last day of appointment for each Trustee appointed by the City Commission. Such appointed Trustee must then take a one (1) year break before seeking reappointment to the Pension Board.

## **Staff, Consultants & Others**

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## **AGENDA ITEM 3**

**ITEM 3.a.**

**MINUTES of  
FEBRUARY 25, 2016 REGULAR  
PENSION BOARD MEETING**

**MINUTES  
REGULAR PENSION BOARD MEETING  
CITY OF HOLLYWOOD EMPLOYEES' RETIREMENT FUND  
THURSDAY, FEBRUARY 25, 2016**

**1. CALL TO ORDER**

Vice-Chair Greene called the meeting to order at 9:00 a.m.

**2. ROLL CALL AND PLEDGE OF ALLEGIANCE**

Board Members present: Chair Phyllis Shaw (arrived at 9:38 a.m.), Vice-Chair Jeffrey Greene, Ralph Dierks, Raquel Elejabarrieta, George Keller (arrived at 9:24 a.m.), Daniel Matlow (arrived at 9:53 a.m.) and Richard Templeton. Also present: Pension Coordinator, Lisa Castronovo; Board Secretary, Tammie Hechler; Board Treasurer, Matthew Lalla; and Attorney Glenn Thomas for Board Attorney James Linn (Lewis, Longman & Walker).

**3. CONSENT AGENDA**

- a. January 28, 2016 Regular Meeting Minutes
- b. February 18, 2016 Special Meeting Minutes
- c. Ratification of Distributions (Contributions and DROP) and Plan Expenses
- d. Approval/Ratification of New Retirement/DROP/Vested/Death Annuities

**MOTION** made by Mr. Dierks, seconded by Mr. Templeton, to approve Consent Agenda Item 3.a. (Vice-Chair Greene requested an explanation be added to Item 5.b. regarding the reason he did not vote.) In a voice vote by the members present, all members voted in favor. **Motion** passed 4-0.

**MOTION** made by Mr. Dierks, seconded by Ms. Elejabarrieta, to approve Consent Agenda Items 3.b-d. In a voice vote by the members present, all members voted in favor. **Motion** passed 4-0.

**6. LEGAL ISSUES (Glenn Thomas) – Taken out of order**

- b. Ordinance Amendment Update

Mr. Thomas reported the Ordinance Amendment was forwarded to the City's legal department.

- a. Litigation Update

Mr. Thomas reported he had reached out to someone at the law firm regarding the Board's concerns and was waiting for a call back.

Per the Board's request, Mr. Reynolds addressed the potential securities litigation case presented by Saxena White regarding Apollo Education. Mr. Reynolds advised the problem was that Apollo Education was sold for less than its average price over the prior 12-month period. Money manager Thompson Siegel & Walmsley did not think the price at which Apollo was sold was a bad price. Mr. Templeton stated he felt the Board's concern was whether there was a cover-up on Apollo's part that caused its price to drop. Discussion followed.

**MOTION** made by Mr. Templeton, seconded by Mr. Dierks, to follow the advice of the attorney and become a participant in the lawsuit regarding Apollo Education. In a voice vote by the members present, all members voted in favor. **Motion** passed 5-0.



**4. TREASURER'S REPORT (Matthew Lalla) – Taken out of order**

Mr. Lalla reported a decrease in the Fund's assets of \$13.1 million/4.36% (net of disbursements) from \$300.44 million on October 2, 2015 to \$287.34 million on February 22, 2016.

**5. INVESTMENT ISSUES (Keith Reynolds, Segal Rogerscasey)**

**b. December 31, 2015 Quarterly Performance Review – Taken out of order**

Mr. Reynolds reported the Fund's rate of return for the quarter ended December 31, 2015 was 3.34% which was 30<sup>th</sup> in comparison to its peer group. Both real estate money managers did very well with double digit returns for the 2015 calendar year.

**c. Flash Performance Review**

Mr. Reynolds's reported the Fund's market value on January 31, 2016 was \$285.6 million with a rate of return of -3.11% compared to the benchmark of -3.18%. Mr. Reynolds noted the equity markets performed poorly in January due to dropping oil prices, slowing growth in China and a general global slowdown. Mr. Reynolds reported the overall target allocations looked good and the real estate allocation (13.3%) would be closer to its target (10.0%) by March 31, 2016 when \$2.5 million from Morgan Stanley would be sold and transferred to another asset class. The fiscal year-to-date return was very flat due to very poor returns in January 2016.

**d. Investment Policy Review**

Mr. Reynolds reviewed the changes he had made to the "Statement of Overall Investment Objectives and Policy" (copy made a part of these Minutes). The main changes were to target allocations and the addition of benchmarks, investments and guidelines for private equity and global infrastructure.

When Mr. Templeton stated that ERISA did not apply to the Fund (referring to the last paragraph on page 1 talking about ERISA), Mr. Thomas suggested adding a reference to FL Statutes Chapter 112.

**a. Neuberger Berman Presentation (William Wallace & John Buser) – Taken out of order**

Mr. Reynolds introduced Mr. Wallace and Mr. Buser from Neuberger Berman who in turn discussed their report (Report made part of these minutes) on private equity investment opportunities and specifically an investment in Neuberger Berman's Crossroads Fund XXI. Mr. Wallace discussed the benefits of investing in private equity funds with Neuberger Berman including Neuberger's broad investment style, geographic and strategy range, their deep team of investors and experienced leadership in the private equity market industry. Mr. Buser provided an overview of Neuberger Berman's Crossroads Fund XXI, noting specifically the Fund's target size of \$650 million, its commitments to date (15 closed and 6 pending totaling \$121.7 million), its asset classes, strategies and geographies.

Discussion ensued regarding a Fund investment in Neuberger Berman's Crossroads Fund XXI.

**MOTION** by Mr. Matlow, seconded by Mr. Templeton, based on Segal Rogerscasey's recommendation, to approve Neuberger Berman as the private equity money manager with a \$20 million investment commitment. In a voice vote by the members present, all members voted in favor. **Motion** passed 7-0.

**7. ADMINISTRATIVE ISSUES – Taken out of order**

There was a discussion regarding the Request for Proposal (RFP) for a Retirement Fund custodian, specifically when to meet to review the responses and whether a subcommittee should be assigned to review them. Mr. Templeton stated all seven trustees should review the responses.

**a. Trustee Education**

Chair Shaw said she felt each new Board Member should be required to attend FPPTA's Trustees School Basic Education course. Mr. Templeton stated that, in his opinion, no one should serve as a Board trustee until after they obtained basic trustee education in advance of being elected or appointed to the Board and thus the Board should sponsor or offer a class for persons interested in becoming a trustee. Chair Shaw agreed with Mr. Templeton and added that she would like to see the City Commissioners educated in the basics of retirement plans. Mr. Keller agreed with Chair Shaw. Mr. Matlow felt a trustee candidate should be given the opportunity to take the educational trustee classes which would in turn be an advantage for appointment to the Board by the City Commission versus a candidate who did not take advantage of attending the educational classes. Chair Shaw stated all of the Boards on which she served required some basic background education prior to being accepted on the board and this Board should be no different.

Chair Shaw stated she would like to see a Fund newsletter mailed out more often than once a year in order to keep interested parties up-to-date on various items regarding the Retirement Fund. Mr. Templeton agreed, but would like to hire someone to prepare the newsletter since the Pension Coordinator most likely did not have the time to dedicate to a more often published newsletter.

**8. PUBLIC COMMENTS**

Public comments were heard from: Ronald Bolton - 1150 NW 71 Avenue, Plantation, FL; Robert Strauss, Vice President - AFSCME Local 2432, 2734 Hollywood Boulevard, Hollywood, FL

**9. TRUSTEE REPORTS, QUESTIONS AND COMMENTS**

Vice-Chair Greene, Chair Shaw and Messrs. Keller and Templeton thanked Mr. Dierks for his service, integrity and dedication to the Fund and its members. Mr. Dierks expressed his appreciation to the Board.

**10. PENSION COORDINATOR'S REPORT (Lisa Castronovo)**

Ms. Castronovo reviewed various items of her February 22, 2016 memorandum to the Board (memo made part of these minutes). Specific discussion items: 1) regarding responses to the RFP for Retirement Fund custodian, a date will be set at the March 17, 2016 Board meeting at which time the Board will review and rate the respondents; and 2) Ms. Castronovo will contact Wells Fargo regarding their offer to reduce their annual fees by approximately \$20,000 beginning.

In regards to the two (2) disability applications she had, Ms. Castronovo reported she also had the names of physicians to which the applicants could be sent. The Board agreed that Ms. Castronovo should work with Ms. Hechler to compile a list of the top three (3) physicians for each specialty who were interested and able to work with the Board on disability cases.

Vice-Chair Greene presented Mr. Dierks a plaque in gratitude for his years of service on the Board.

**11. ADJOURNMENT**

**MOTION** made by Chair Shaw, seconded by Mr. Matlow, to adjourn the meeting. In a voice vote by the members present, **Motion** passed 7-0. Meeting adjourned at 11:53 p.m.

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Phyllis Shaw, Chair

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Date

**ITEM 3.b.**

**RATIFICATION OF  
DISTRIBUTIONS  
(Contributions and DROP)  
and  
PLAN EXPENSES**

# **PLAN DISTRIBUTIONS**

**EMPLOYEES' RETIREMENT FUND**  
**Refunds and Distributions**  
**March 17, 2016 Regular Pension Board Meeting**

**Planned Retirement Distribution**

<b><u>Name</u></b>	<b><u>Refund</u></b>
Bertrand, Glendina	\$ 114,465.24
	<u>\$ 114,465.24</u>

**DROP Distributions**

Class, Emilia	\$ 121,623.70
Coyle, Charles *	13,585.19
Istvan, George	316,635.32
	<u>\$ 451,844.21</u>

**TOTAL: \$ 566,309.45**

\* Payout of balance of DROP account

# **PLAN EXPENSES**

# EMPLOYEES RETIREMENT FUND

## Payment Requests Processed During the Period

February 1, 2016 through February 29, 2016

### Manager Fees

Brandes Investment Partners (quarter ending 12/31/15)	\$ <u>35,691.00</u>
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### Pension Coordinator Fees

LECastronovo Co., Inc. (February 2016)	<u>13,173.33</u>
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### Travel Advances/Expenses

FPPTA Trustees School (Orlando, Florida)	
Jeffrey Greene	1,142.68
Ralph Dierks	1,018.14
Lisa Castronovo	(450.00)
	<u>1,710.82</u>

### Miscellaneous

UPS	39.38
HostGator	10.95
Wells Fargo Business Card Late Fee	39.00
Wells Fargo Business Card Interest	100.64
	<u>189.97</u>

Total	\$ <u><u>50,765.12</u></u>
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**ITEM 3.c.**

**APPROVAL/RATIFICATION of  
NEW RETIREMENTS/DEATHS**

**EMPLOYEES' RETIREMENT FUND**  
**New Retirement/DROP/Death/Vested Annuities - Monthly Amounts**  
**March 17, 2016 Regular Pension Board Meeting**

**December 2015**

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Mathis, Jeffrey - retirement (Police transfer)	\$ 272.96
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**February 2016**

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Candelmo, Ernest - retirement (Police transfer)	\$ 290.65
Class, Emilia - retirement (from DROP)	1,785.38
D'Emilio, Alice - retirement	3,020.96

**March 2016**

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Schmitz, Heidi - retirement (from Vested)	\$ 361.01
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**Benefits Stopped**

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Markham, Roger - died 2/27/2016 *	\$ 819.59
Schulman, Charles - died 2/11/2016 *	514.60
Szewczyk, Helen - died 2/3/2016	736.90

\* Death Certificate has been requested

## **AGENDA ITEM 4**

**NO BACKUP  
FOR THIS SECTION**

## **AGENDA ITEM 5**

## **ITEM 5.a.**

### **FLASH PERFORMANCE REVIEW**

**(Backup material not available  
at the time of this printing)**

## **ITEM 5.b.**

### **INVESTMENT POLICY**

# **CITY OF HOLLYWOOD EMPLOYEES' RETIREMENT FUND**

## **Statement of Overall Investment Objectives and Policy**

*Adopted: November 23, 2004*

*Effective: December 25, 2004*

*Amended:*

- May 2006*
- March 2008*
- July 2008*
- February 2015*
- February 2016*



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The Board of Trustees of the City of Hollywood Employees' Retirement Fund (the "Fund") hereby adopts this Statement of Investment Objectives and Policy (the "Statement"). The purpose of the Statement is to set forth the investment objectives and guidelines applicable to Fund investments, and will be incorporated into all existing and any future investment management agreements with each investment manager (the "Investment Manager") retained by the Fund. Each such Investment Manager shall acknowledge and agree to the objectives set forth in the Statement and the manager specific guidelines appended as Exhibit "A" hereto (the "Guidelines").

This investment policy establishes and sets forth objectives and policies that the City of Hollywood Employees' Retirement Fund ("Fund") is to adhere to in the administration of its investments. This policy is adopted in accordance with Section 112.661, Florida Statutes, and upon adoption by the Board of Trustees ("Board") will be filed with the State of Florida Department of Management Services, the City of Hollywood and the Fund's consulting actuary.

One of the primary objectives of this Statement and Guidelines is to foster an effective working relationship with the Investment Managers through a discipline of good communication. The Statement and Guidelines are intended to provide the Board and the Investment Managers with a foundation from which to formulate specific investment strategies and goals so that the Board and any independent investment consultant retained by the Fund (an "Investment Consultant") can effectively implement the Fund's investment policies and strategies, as well as evaluate the performance of the Investment Manager and oversee the management of Fund investments in a prudent manner.

This Statement is not intended to remain static. The Board and its Investment Consultant will periodically review the Statement and update it as necessary. Recommendations for its modification from the Investment Manager are expected when investment conditions so warrant.

The Board is charged with the responsibility for the investment of the assets of the Fund. Board members shall discharge their duties solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the Fund. They shall discharge their duties with the care, skill, prudence and diligence under the circumstance then prevailing that a prudent man, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character and with like aims; by diversifying the investments of the Plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.

In performing their investment duties, the Board and to the extent legally permissible, its investment managers, shall comply with the fiduciary standards set forth in ERISA (Employee Retirement Income

Security Act of 1974, as amended {[29 USC 1104) (a) (1) (A) - (C)] and section 112.656, Florida Statutes.

It is the intention of the Board to allow each Investment Manager full investment discretion in investing its Account within the scope of this Statement and the Guidelines. The Board and the Investment Manager agree that this Statement and the Guidelines are incorporated into the investment management agreement between them (the "Agreement") and shall be considered by the Investment Manager in formulating its strategy for investing the Fund's assets. This Statement and the Guidelines shall control in the event of any conflicting provisions set forth in the Agreement.

The balance of this document is organized into the following components:

A. Investment Objectives (Section II): The investment objectives that the Board judges to be appropriate and prudent to implement their strategic planning for the investment of the Fund's assets;

B. Investment Policies (Section III): The general investment policies and objectives and performance expectations for the Investment Managers;

C. Performance Measurement (Section IV): The approach that the Board will use to measure the investment performance of each Investment Manager and to ensure that the Fund remains invested in accordance with the principles set forth in this Statement;

D. Account Investment Policies (Section V): The general investment policies and objectives of the Investment Manager's Account;

E. Communication and Reporting (Section VI): Accounting and reporting guidelines for purposes of measuring the performance of the Investment Managers;

F. Proxy Voting Policies (Section VII): Specific rules setting forth the Investment Managers' right and obligation to vote proxies appurtenant to Fund securities.

A. The investment horizon of the Fund is long term. The Fund's primary investment objective is to maximize the total rate of return subject to the preservation of capital, while assuming less risk than 100% exposure to equities and or fixed income provides.

Preservation of capital encompasses two goals:

- > minimizing the risk of loss of principal for the Fund as a whole; and
- > minimizing the erosion of principal value through inflation.

B. The primary means by which capital preservation is to be achieved is through diversification of the Fund's investments across asset classes. The appropriate level of risk for the Fund was determined by examining the risk and reward of numerous asset allocation alternatives as presented by, and formulated in consultation with, the Investment Consultant. Within each asset group, further diversification is to be achieved through investment in securities across numerous industries and sectors as determined in the sole and absolute discretion of the Investment Managers in accordance with the Agreement, this Statement and the Guidelines.

C. No distinction need be made between realized and unrealized capital gains or losses. All investment income of an Account and all realized and unrealized capital gains and losses will be considered in computing the investment performance of the Account, except to the extent the Investment Manager is specifically directed otherwise in writing.

D. The total Fund has long-term performance expectations as follows:

### **1. Customized Index**

Over a complete market cycle (3-5 years), the Total Fund has an additional investment performance goal of outperforming a weighted portfolio comprised of a mix of 25% S&P 500 Index / 12.5% Russell 2500 Index / 15.0% All Country World ex US (net) Index / 5.0% MSCI EAFE Small Cap (net) Index / 7.5% NCREIF ODCE Equal Weighted Index, 2.5% NCREIF Property Index, 32.5% Barclays Intermediate Aggregate Bond Index.

## 2. Actuarial Assumption

The Fund's investment program will be designed to achieve a minimum investment performance goal ~~equal to its actuarial assumption, currently 8.0%,~~ as measured over a complete market cycle, equal to its actuarial assumption, currently 7.8% as of 10/1/15, which rate will be lowered by 0.1% each year until it reaches 7.5% as of 10/1/18.

For each actuarial valuation, the Board will determine the total expected annual rate of return for the current year, for each of the next several years, and for the long term thereafter. This determination will be filed with the State of Florida's Department of Management Services, with the City of Hollywood and with the Fund's consulting actuary.

**A. Asset Allocation and Investment Manager Structure**

In order to provide an appropriate level of diversification for the Fund, Investment Managers with complementary or diverse investment styles will be retained. It is not the intention of the Board to become involved in day-to-day investment decisions. Therefore, the Board has appointed several Investment Managers to manage (including the power to acquire, or dispose of) assets within the portion of the total Fund allocated to the particular Investment Manager, in a manner consistent with the Agreement, this Statement and the Guidelines. To the extent possible, it is the intention of the Board that the investment managers competitively bid the purchase of securities when feasible and appropriate. Except otherwise required by law, the most economically advantageous bid is to be selected. Neither this Statement nor the Guidelines are intended to direct an Investment Manager to purchase or sell any specific security or to effect or refrain from effectuating any specific investment transaction for its Account. The Board will neither assume any obligation or responsibility for the direct management of Account assets allocated to the Investment Manager nor be liable for any acts or omissions of the Investment Manager that result in any loss to the Account.

**B. Asset Deployment Policy**

The guidelines that the Board of Trustees has adopted for the overall allocation of the Fund's assets are as follows:

<b>Asset Allocation</b>	<b>Target (%)</b>	<b>Ranges (%)</b>
Domestic Equity	30.0	25-42.5
Large Cap	20.0	15-30
Small Cap	10.0	7-15.5
International Equity	20.0	15-25
Large Cap	15.0	11-19
Small Cap	5.0	2.5-7.5
Fixed Income	30.0	25-37.5
Intermediate	15.0	10-20
Core Plus	15.0	10-20
Real Estate	10.0	7-14
Core	7.5	4.5-10.5
Value Added	2.5	1-5
Private Equity	7.5	0-15
Diversified	5.0	0-10
Secondaries	2.5	0-5
Global Infrastructure	2.5	0-5
Cash	0	0-5

To the extent necessary, an attempt will be made to match investment maturities with known cash needs and anticipated cash-flow requirements and to hold an appropriate dollar amount of investments for liquidity purposes.

**C. Rebalancing Guidelines**

The Board, with assistance from the Investment Consultant, will monitor the Fund's overall asset allocation within the parameters described above. They will do so by giving specific instructions as to the range of allowable asset classifications to individual Investment Managers and by monitoring quarterly the asset classifications actually held by such Investment Managers. The Board recognizes that markets generally do not move in concert, and that actual allocations will deviate from the targets. If the assets deviate from the ranges as outlined above, the Board will authorize rebalancing back to targets.

The performance expectations of the Board are hereby communicated to the Investment Managers in their respective Guidelines. These will include comparison to benchmark returns and standard deviations as well as universe comparisons. Quarterly performance will be evaluated to test progress toward attainment of longer-term goals.

The Board recognizes the possibility that losses may occur from time to time in an Account. The Board will not regard such losses alone as evidence of imprudence, provided that the overall investment performance of the Investment Manager is consistent with the objectives set forth in this Statement and the Guidelines, relevant investment industry benchmarks over appropriate time periods, and the investment style that the Investment Manager was retained to pursue (as it may be modified through subsequent written communications with the Board). It is understood that there are likely to be short-term periods during which the performance of an Investment Manager deviates from market indices. During such times, greater emphasis shall be placed on performance comparisons with investment managers employing similar styles.

Set forth below are the criteria that the Board and the Investment Consultant will use to evaluate the performance of each Investment Manager, depending upon the type of portfolio being managed. The Investment Manager will be expected to:

**A. Domestic Equity Portfolio (Large Cap Index)**

1. Achieve a rate of return that approximates the Investment Managers' respective index/benchmark.

**B. Domestic Equity Portfolio (Small + Mid Cap)**

1. Achieve a rate of return that exceeds the Investment Managers' respective index/benchmark net of investment management fees over a complete market cycle (3-5 years).
2. Achieve a positive risk/reward trade-off when compared to the respective index/benchmark.
3. Achieve cumulative performance results, which rank above the median of a universe comprised of equity investment managers with similar style characteristics.

**C. International Equity Portfolios (Large + Small)**

1. Achieve a rate of return that exceeds the Investment Managers' respective index/benchmark net of investment management fees over a complete market cycle (3-5 years).
2. Achieve a positive risk/reward trade-off when compared to the respective index/benchmark.
3. Achieve cumulative performance results, which rank above the median of a universe comprised of equity investment managers with similar style characteristics.

**D. Domestic Fixed-Income Portfolios (Intermediate + Core)**

1. Achieve a rate of return that exceeds the Investment Manager's respective index/benchmark net of investment management fees over a complete market cycle (3-5 years).
2. Achieve a positive risk/reward trade-off when compared to the respective index/benchmark.
3. Achieve cumulative performance results, which rank above the median of a universe comprised of fixed income managers with similar style characteristics.

**E. Real Estate Portfolio (Core + Value Added)**

1. Achieve a rate of return that exceeds the respective index/benchmark net of investment management fees over a complete market cycle (3-5 years).
2. Achieve a positive risk/reward trade-off when compared to the respective index/benchmark



**F. Private Equity Portfolio (Diversified Fund of Funds + Secondaries)**

1. To outperform public benchmarks by 300 basis points net of investment management fees over the long term (7-10 years).

**G. Global Infrastructure**

1. Achieve an absolute return of 8-9% net of investment management fees over the long term (7-10 years).

**A. General**

The Board has sole and absolute discretion to select Investment Managers and to replace them when necessary. The Board, with the assistance of and in consultation with the Investment Consultant, will review each Investment Manager's portfolio, and meet with each Investment Manager at least annually to review the portfolio investments, investment returns, changes in the Investment Managers staff, market conditions and environment, and any other pertinent items.

Except with the advance written approval of the Board, the Investment Manager is prohibited from entering into any transactions for the Fund that are not authorized by this Statement or the Guidelines, including, without limitation, making any investment in a security or investment specifically prohibited by the Statement or the Guidelines.

**B. Legal Compliance**

The Investment Manager is expected to perform their fiduciary duties prudently. Each Investment Manager shall at all times discharge its responsibilities with respect to the Account it manages on the Fund's behalf. In addition, the investment manager(s) shall be registered as an investment manager with the Securities Exchange Commission.

Each Investment Manager appointed by the Board to execute the policy will invest plan assets in accordance with the policy and their judgments concerning relative investment values. In particular, the Investment Manager will be accorded full discretion, within policy limits, and within the requirements of applicable laws, to (1) select, purchase, and invest in, individual securities; (2) make periodic adjustments to the proportions of equity securities, fixed-income securities and cash equivalents; and (3) diversify plan assets. The Investment Managers shall discharge their responsibilities with respect to the Fund's assets in accordance with their fiduciary responsibility.

**A. Asset Class Investment Guidelines****1. Domestic Equity**

Exceptions to these guidelines will be noted in the Manager Specific Guidelines found in Exhibit A of this document.

- a. Equity investments shall be made with a view towards achieving a total rate of return (market appreciation plus dividend income).
- b. All equity investments shall be of companies whose respective market capitalizations are consistent with the Investment Manager's specific benchmark. All equity securities must have a minimum capitalization of at least \$50 million.
- c. Equity investments of an Account may be made in securities such as common stocks, convertible securities including debentures, and American Depositary Receipts (ADRs) or U.S. Dollar denominated stocks of foreign companies.
- d. All securities shall be of a class listed on a national securities exchange (e.g., the New York Stock Exchange, the American Stock Exchange, and the NASDAQ National Market system, or the Over-the-Counter securities) or traded in the over-the-counter market and quoted in the National Association of Securities Dealers Automatic Quotation Service.
- e. Industry and sector allocations within an Account must ensure prudent diversification and risk control.
- f. Investment in any issuer (measured at fair market value) must at all times be limited to 5% of the fair market value of an Investment Manager's Account.
- g. The maximum total account investment in any one company shall be less than 5% of that company's outstanding voting stock and less than 5% in value of all outstanding shares of all classes of stock of the issuer (assuming all conversions have been made by the account).
- h. Investment in ADRs or U.S. Dollar denominated stocks of foreign companies (measured at fair market value) must at all times be limited to 10% of the fair market value of an Investment Manager's Account.
- i. Investments in convertible securities (measured at fair market value) must at all times be limited to 5% of the fair market value of an Investment Manager's Account.

**2. International Equity**

a. International Equity investments will be made through the purchase of units of commingled funds or group trusts.

b. Any such commingled fund or group trust shall comply with its own investment guidelines, outlined in the Memorandum(s) and Trust Agreement(s). A copy of the investment guidelines and objectives of the commingled fund or trust shall be provided to the Board of Trustees and its Investment Consultant. In addition, should the investment guidelines and objectives be modified, the Board of Trustees and its Investment Consultant shall be notified promptly in writing as to the specific change and shall be provided with a copy of the modified investment guidelines and objectives.

**3. Domestic Fixed Income**

Exceptions to these guidelines will be noted in the Manager Specific Guidelines found in Exhibit A of this document.

The fixed income portion of an Account shall be invested in marketable fixed income securities of the first four quality grades as established by one or more of the nationally recognized bond ratings services. The average quality of all the bond holdings in an Account should be maintained at AA or better. The following instruments are acceptable:

- a. Commercial Paper or Variable Rate Notes rated P-1 by Moody's, A1 by Standard & Poor's or F1 by Fitch.
- b. Certificates of Deposit and Bankers Acceptances rated A or better by Moody's Investor's Service or equivalent by Standard & Poor's.
- c. United States Treasury Bonds, Notes and Bills.
- d. Debt instruments of the U.S. Government or its Agencies (backed by the full faith and credit of the U.S. Government).
- e. Marketable corporate debt, mortgages, and asset-backed securities rated the equivalent of BBB or better by Moody's Investors Services, Standard & Poor's, or Fitch Investor's Services. In case of split rating among the rating services, the manager shall defer to the highest rating.

f. The effective duration of an Account should be no more than +/- 25% of the duration of the Investment Manager's benchmark, unless otherwise specified in an Investment Manager's Guidelines.

g. Securities downgraded by any or all-rating agencies subsequent to purchase resulting in violation of quality guidelines must be sold immediately upon downgrade. If there is no immediate market for the security, then the Board must be notified that the downgraded security has not been sold. A continued effort to sell must be made and immediate notification must be provided to the Board once the security has been sold.

h. At all times, an Investment Manager may not hold more than 5% of its Account (measured at fair market value) in any one issuer's securities other than direct obligations of the U.S. Government or its agencies.

i. Investments in preferred stock, warrants and convertible securities (measured at fair market value) must at all times be limited to 5% of the fair market value of an Investment Manager's Account. Warrants that were received and distributed due to direct ownership of securities of a company are excluded from this limitation.

j. An Investment Manager may invest in dollar denominated foreign bonds subject to the restrictions set forth herein and also not more than 10% of the fair market value of its Account.

#### **4. Real Estate**

The real estate portion of the Fund's assets may be invested in pooled real estate vehicles, limited partnerships, or other types of real estate investments as determined by the Board in consultation with the Investment Consultant.

#### **5. Private Equity**

The private equity portion of the Fund's assets may be invested in institutional commingled fund vehicles. As a result, the guidelines established under the private placement memorandums and subscription documents that govern the fund vehicles supersede all other client guidelines.

The following represents a summary of the guidelines required for investment in private equity.

a. Acceptable Strategies

Diversified portfolio of illiquid private investments. Portfolio may include domestic and international investments in partnerships, direct co-investments, and secondary interests.

b. Diversification:

The investments shall be diversified by economic sector, vintage year, geographic location, and by stage of company maturity.

**6. Global Infrastructure**

The global infrastructure portion of the Fund's assets may be invested in institutional commingled fund vehicles. As a result, the guidelines established under the private placement memorandums and subscription documents that govern the fund vehicles supersede all other client guidelines.

The following represents a summary of the guidelines required for investment in global infrastructure.

a. Acceptable Strategies:

Diversified portfolio of infrastructure investments. Portfolio may include domestic and international investments in partnerships, direct co-investments, and secondary interests.

b. Diversification:

The investments shall be diversified by sector, vintage year, number of transactions, and geographic location.

**7. Cash and Cash Equivalents**

Uninvested cash balances of an Account should be zero or maintained at an absolute minimum at all times (unless clearly prudent not to do so), through the prompt investment of available funds in short-term security holdings, cash equivalents (which includes only commercial paper rated A-1 or P-1, by Standard and Poor's or Moody's respectively, U.S. Government and U.S. Agency obligations, bank money market instruments, or bank certificates of deposit) or other prudent and appropriate common, collective or pooled trusts. The use of common, collective or pool trusts or funds, or "money

market” instruments, is permissible only if the securities within such funds meet the general quality (and other) constraints of this Statement and the Guidelines.

Certificates of Deposit (“CDs”), maturing within 12 months, of any domestic bank meeting the standards for a “well-capitalized” bank pursuant to the FDIC Improvements Act of 1991, are appropriate investments, provided that such CDs from any single institution may not represent more than 5% of the assets of the total short-term investment account. CDs shall not exceed more than \$100,000 at any single banking institution. Any CDs purchased must have a minimum rating of three stars as rated by the Bauer Financial Group and cannot be purchased from a non-FDIC insured bank.

#### **8. Other Investments**

The Board, after consulting with the Investment Consultant, may authorize the use of any other investment for an Account provided that such investment is considered prudent for a retirement fund. Assets that provide appropriate diversification (specifically low correlation with existing assets) will be considered.

#### **9. General Restrictions**

- a. The Investment Managers may not invest in commodities, private placements (including, without limitation, gold or currency futures), direct real estate investments (unless specifically allowed), oil, gas and mineral exploration investments, and nominally public issues for which the market is severely restricted.
- b. Investment Managers are prohibited from investing in letter stocks or other unlisted or restricted securities, uncovered options, futures and forward contracts and any other such derivative instrument; or from engaging in short sales, margin transactions or other specialized investment activities.
- c. No assets may be invested in securities whose issuers have filed a petition for bankruptcy.
- d. An Investment Manager shall not use any commingled fund (other than with respect to Cash and Cash Equivalents as specifically allowed by this statement), unless the Investment Manager notifies the Board and the Investment Consultant in advance, in writing, of its desire to use such other fund and the Board grants written approval.

- e. The Investment Managers shall not use derivative securities to increase portfolio risk above the level that could be achieved in the portfolio using only traditional investment securities or to acquire exposure to changes in the value of assets or indexes that by themselves would not be purchased for the portfolio. Under no circumstances will an Investment Manager undertake a derivative investment possessing elements of leverage or that is non-covered or leveraged to the extent that it would cause portfolio duration to exceed the limits implied by the benchmark. In addition, fixed income securities whose returns are tied to another security or currency are specifically prohibited (except warrants and convertibles referred to above).
- f. Investment in Class B mortgage derivatives is not permitted. Class B means securities the value of which changes as a multiple of the underlying security. This includes interest only and principal only bonds, inverse floaters, leveraged floaters, instruments with internal leverage and other complex leveraged securities. In addition, investment is prohibited in mortgage-backed derivative securities with any of the following characteristics: leverage, more pre-payment risk than the underlying mortgage collateral and/or risk from other tranches (including, without limitation, "Z," "Support" or "Companion" bonds).
- g. The Investment Managers may not make any investment in guaranteed insurance or other investment contracts issued by an insurance company, without the prior permission of the Board.
- h. Repurchase agreements and reverse repurchase agreements against securities are not permitted to be held in an Account, subject to the other guidelines in this Statement and the Guidelines.
- i. The Investment Managers may not invest in private placement or venture capital issues or unrated securities.
- j. The Investment Manager may not engage in any transaction involving loans of portfolio securities without the specific, advance written approval of the Board.
- k. Foreign currency may not be purchased without the written approval of the Board.

**B. Cure Period**

An Investment Manager shall be allowed a period of up to three months to remedy any instance in which its Account, due to market fluctuation, exceeds any of the percentage limitations set forth in this Statement or the Guidelines, by reducing the exposure as soon as prudently possible.



**C. Brokerage**

Investment Managers must use best efforts to obtain the best execution of portfolio transaction orders placed on behalf of the Fund, through responsible brokerage firms at the best prices and at reasonably competitive commission rates. The Investment Manager acknowledges that the Plan participates in a commission recapture program and will participate in the program on behalf of the Plan to the extent that best execution of orders is achieved.

As to investments in any security for which an Investment Manager or any of its affiliates is a market maker, the Investment Manager agrees that it will not effect the transaction for that investment through itself or any of its affiliates unless (a) the Investment Manager is able to demonstrate in writing after the transaction that such trade is lawful, would not constitute a non-exempt prohibited transaction under Internal Revenue Code and (b) the Investment Manager provides the Board and the Investment Consultant written notice of such investment after the transaction.

**D. Third Party Custodial Agreement**

All of the Fund's securities purchased, and all collateral obtained, shall be held in third-party safekeeping by a custodian selected by the Board, except for certificates of deposits and other time deposits, which are collateralized pursuant to Chapter 280 of the Florida Statutes, and should be properly designated as an asset of the Plan. No withdrawal of securities, in whole or in part, shall be made from safekeeping except by the authorized custodian. Security transactions between a broker-dealer and the investment managers involving purchases or sales of securities by transfer of money or securities must be made on a "delivery vs. payment" basis to ensure that the custodian will have the security or money, as appropriate, in hand at the conclusion of the transaction.

**E. Internal Controls**

The Board established the following internal controls to protect the Fund's investments against fraud, embezzlement, theft, mismanagement, misrepresentation by third parties, loss and error. These controls are to be reviewed by the Fund's independent auditors as part of the Fund's annual financial audit.

➤ Keep duties separate to avoid collusion and fraud. The Fund's Treasurer will see that investments are recorded separately from the investment managers. Investment transactions will be

reviewed prior to recording them in the general ledger to ascertain compliance with investment policy.

- Comparison of monthly portfolio from investment manager against custodian statements to detect and investigate any differences.
- Require third-party safekeeping, as discussed in item F. Custodian will provide statements reconciled against investment managers' statements.
- Purchase book-entry securities only. Do not purchase bearer form or physical delivery securities.
- Maintain delegation of and control over investment authority through written procedures or Board decisions.
- Enter into formal agreements with the custodial bank and investment managers and require sufficient insurance coverage.

#### **F. Continuing Education**

The Board recognizes schools and conferences as sources of continuing education on pension and investment issues. Board members shall attend two (2) pension-related seminars within the first year of service to the Pension Board. Continuing members shall attend at least one (1) pension-related program per year. Appropriate staff members must attend educational programs on a rotating basis.

#### **G. Reporting**

An annual financial report will be distributed to the City Commission and to fund participants, which shall include investments, by type, at fair value and income earned. This report will be filed with the City Clerk as a public document and will be available to the general public.

#### **H. Valuation of Illiquid Investments**

The Board defines an illiquid investment as one for which a generally recognized market is not available or for which there is no consistent or generally accepted pricing mechanism. Should an investment become illiquid or in the event that the fund acquires an illiquid investment, the Board shall follow the criteria set forth in Section 215.47(6), Florida Statutes, except that submission to the Investment Advisory Council is not required.

**A.** Each Investment Manager is required to provide quarterly written reports to the Board and the Investment Consultant. The quarterly reports should contain, at a minimum, the following information:

1. Identity of every security held under the Account (organized by sector), with an indication of its market and book value.
2. Performance results compared with appropriate benchmarks.
3. Quality ratings of the fixed income investments including average quality.
4. The characteristics of the aggregate holdings of the Investment Manager's Account in comparison with the Investment Manager's particular benchmark.
5. A record of all proxy decisions, including, without limitation, the company name, the number of shares voted, a description of the issues voted upon, and how the shares were voted. A summary of the proxy voting for the year should also be included in the fourth quarter year-end report.
6. A certification, signed by an authorized officer of the Investment Manager, that no event required to be reported in Section VI.B. of this Statement has occurred in the quarter other than as reported to the Board and the Investment Consultant in writing in accordance with Section VI.B.

**B.** Each Investment Manager must also provide in writing certain information to the Board and the Investment Consultant as soon as possible following the occurrence of an event. This information includes:

1. Notice of changes in organizational structure, ownership and key personnel of the firm, or financial condition. This information must be provided as soon as possible, but in no event more than 14 days after the Investment Manager knows or should know about the change.
2. Notice of any litigation, investigations by any governmental body, and any other pertinent information that might be material to the Fund. This information must be provided as soon as possible, but in no event more than 14 days after the Investment Manager knows or should know about the event.
3. A quarterly letter, no later than thirty days after quarter end, stating that the Account is in compliance with this Statement.
4. Any violation of this Statement or the Guidelines. This information must be provided as soon as possible, but in no event more than 5 days after the Investment Manager knows or should know about the violation.
5. In the event that the cumulative accrued losses in the Account exceed 10% in any calendar quarter. This information must be provided as soon as possible, but in no event more than 14 days after end of the quarter.
6. Any transactions that the Investment Manager has not been able to reconcile with the Custodian, after reasonable efforts to do so. This information must be provided as soon as possible, but in no event more than 5 business days after the Investment Manager learns that it is unable to reconcile a transaction with the Custodian.
7. The Investment Manager will provide the Fund Manager and the Investment Consultant with annual notice of the filing of its Form ADV with the SEC, as well as a copy of such filing.

8. Each Investment Manager must meet with the Board and the Investment Consultant as required. The Board expects to receive a written summary, which addresses the subjects identified below at least seven days prior to the meeting:

a. Performance for Past Period: Standard time periods for each report will be last calendar quarter, year to date, latest 12 months, 3 years, 5 years, since inception. Returns should be annualized and calculated on a time-weighted basis for the total portfolio. All returns should include income and dividends and be reported both gross and net of investment management fees.

b. Rationale for Performance Results: Discussion of the rationale for performance results, relating them specifically to investment strategy and tactical decisions implemented during the current review period.

c. Specific Near-Term Strategy: Discussion of the Investment Manager's specific strategy for the portfolio over the near-term period, with specific reference to asset mix (including cash position) and expected portfolio characteristics.

d. Changes in Investment Manager's Firm: Discussion of any changes in the Investment Manager's firm, including professional turnover and client accounts lost.

e. Changes in the Board of Trustees' Requirements: Discussion of any proposed or required modifications to the investment program and strategy.

These meetings will also provide the Investment Manager with the opportunity to explain how its investment strategy/outlook has evolved since previous meetings.

1. Each Investment Manager shall be responsible for reviewing this Statement and the Guidelines at least annually (or more frequently, as the Board or the Investment Consultant deem necessary). Whenever the Investment Manager believes that any particular guideline or objective should be changed, added or deleted, it is the responsibility of the Investment Manager to initiate communication with the Board and the Investment Consultant.

2. The Investment Consultant shall also be responsible for reviewing this Statement and the Guidelines on a continuous basis and promptly informing the Board in the event that the Investment Consultant believes that any particular guideline or objective should be changed, added or deleted.
3. The Investment Managers may not act upon written or oral instructions from any person other than the full Board of Trustees or its duly authorized representatives.

The Investment Managers, rather than the Board, will have sole responsibility for voting all proxies appurtenant to the securities in the Account. In voting such proxies, each Investment Manager shall adhere to the following guidelines:

The Investment Manager shall vote each proxy in a timely manner. All actions and advice with respect to voting proxies appurtenant to portfolio securities must be taken or rendered prudently, and solely in the interest, and for the exclusive benefit, of the Fund and its participants and beneficiaries.

The Investment Manager must provide the Board with its statement of proxy voting guidelines and must adhere to such guidelines, unless inconsistent with applicable law or agreement with the Board to the contrary.

All proxies must be voted unless clearly prudent not to do so. Proxies should be vigorously voted with the interest of preserving or enhancing the security's value.

**Exhibit A**  
**MANAGER SPECIFIC GUIDELINES**

**SECTION VIII**

The above Statement of Investment Objectives and Guidelines is hereby found acceptable to the Investment Manager, the Board of Trustees, and the Consultant. These Guidelines may be executed in counterpart copies, each of which shall be deemed an original, but all of which shall be considered the same instrument. All modifications to these Guidelines shall be in writing and signed by the Board and communicated to the Investment Manager and the Consultant before they become binding.

IN WITNESS WHEREOF this document has been approved by the Pension Board on February 26, 2015.

**City of Hollywood Employees' Retirement Fund**

By: \_\_\_\_\_ Date: \_\_\_\_\_

Investment Manager: \_\_\_\_\_

Receipt confirmed by: \_\_\_\_\_ Date: \_\_\_\_\_



## **AGENDA ITEM 6**

## **ITEM 6.a.**

### **2016 RETIREMENT LEGISLATION UPDATE**

**(No backup material available  
at the time of this printing)**

## **AGENDA ITEM 7**

## **ITEM 7.a.**

### **FUNDING POLICY**

**City of Hollywood General Employees' Retirement System**  
**Actuarial Funding Policy**  
**Adopted: XXXX Y, 2016**

**FUNDING OBJECTIVES**

The main funding objective for the defined benefit provisions of the City of Hollywood General Employees' Retirement System (Plan) is to establish and receive employer contributions, expressed as a percentage of active member payroll, which will remain approximately level from year to year and will not have to be increased for future generations of citizens in the absence of benefit changes. The employer contributions along with member contributions are to be used for funding the long-term costs of benefits, provided by the Ordinance and collective bargaining agreements, for Plan members and beneficiaries. Additionally, the City is responsible for contributing administrative expenses.

From the perspective of the members and beneficiaries, the funding objective is for assets and actuarially determined contributions to be sufficient to pay all benefits provided by Plan when due. From the perspective of the contributing plan sponsors and taxpayers, there are additional funding objectives of keeping the actuarially determined contribution rates relatively stable as a percentage of active member payroll and equitably allocating the costs over the active members' periods of active service. For pension funding, the payment of benefits is supported in part by income earned on investment assets. This actuarial funding policy meets these objectives. It is stipulated by state law and collective bargaining agreements and is implemented through the application of Board adopted governance policies.

**Statutory Pension Funding Policy - Ordinance**

The Ordinance for the Plan sets forth some portions of the actuarial funding policy for the Plan.

**Ordinance Excerpts:**

**Sec. 33.025(O)(b) Financing**

The Fund shall be financed in accordance with actuarial requirements by the following revenues:

- Contributions by the city in an amount which, when added to the members' contributions, will be sufficient to fund the plan on a sound actuarial basis, which contributions shall be made concurrently with contributions from the member according to rates established by the Board upon recommendation of the actuary.

**Sec. 33.025(U) Actuarial Studies**

- An actuarial valuation of the Fund shall be conducted periodically in accordance with applicable law, but at least once every three years.

**City of Hollywood General Employees' Retirement System**  
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**Adopted: XXXX Y, 2016**

- An experience study shall be conducted at least once every five years, and more frequently if authorized by the Board, to review mortality, turnover, disability, interest and other actuarial factors assumed in the calculation of cost and liabilities, and to vary the city's contribution rate.
- Any proposal for changes in the benefit schedule shall be evaluated by the actuary and his or her report and recommendations.

**Statutory Pension Funding Policy – Florida Statutes**

Chapter 112, Florida Statutes sets forth some portions of the actuarial funding policy for the Plan.

**Chapter 112 Excerpts:**

**112.63 Actuarial reports and statements of actuarial impact; review.**

- (1) Each retirement system or plan subject to the provisions of this act shall have regularly scheduled actuarial reports prepared and certified by an enrolled actuary. The actuarial report shall consist of, but shall not be limited to, the following:
  - (a) Adequacy of employer and employee contribution rates in meeting levels of employee benefits provided in the system and changes, if any, needed in such rates to achieve or preserve a level of funding deemed adequate to enable payment through the indefinite future of the benefit amounts prescribed by the system, which shall include a valuation of present assets, based on statement value, and prospective assets and liabilities of the system and the extent of unfunded accrued liabilities, if any.
  - (b) A plan to amortize any unfunded liability pursuant to s. 112.64 and a description of actions taken to reduce the unfunded liability.
- (2) The frequency of actuarial reports must be at least every 3 years commencing from the last actuarial report of the plan or system or October 1, 1980, if no actuarial report has been issued within the 3-year period prior to October 1, 1979. The results of each actuarial report shall be filed with the plan administrator within 60 days of certification. Thereafter, the results of each actuarial report shall be made available for inspection upon request. Additionally, each retirement system or plan covered by this act which is not administered directly by the Department of Management Services shall furnish a copy of each actuarial report to the Department of Management Services within 60 days after receipt from the actuary. The requirements of this section are supplemental to actuarial valuations necessary to comply with the requirements of s. 218.39.
- (3) No unit of local government shall agree to a proposed change in retirement benefits unless the administrator of the system, prior to adoption of the change by the governing body, and prior to the last public hearing thereon, has issued a statement of the actuarial impact of the proposed

**City of Hollywood General Employees' Retirement System**  
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change upon the local retirement system, consistent with the actuarial review, and has furnished a copy of such statement to the division. Such statement shall also indicate whether the proposed changes are in compliance with s. 14, Art. X of the State Constitution and with s. 112.64.

**112.64 Administration of funds; amortization of unfunded liability.**

- (1) Employee contributions shall be deposited in the retirement system or plan at least monthly. Employer contributions shall be deposited at least quarterly; however, any revenues received from any source by an employer which are specifically collected for the purpose of allocation for deposit into a retirement system or plan shall be so deposited within 30 days of receipt by the employer. All employers and employees participating in the Florida Retirement System and other existing retirement systems which are administered by the Department of Management Services shall continue to make contributions at least monthly.
  - (2) From and after October 1, 1980, for those plans in existence on October 1, 1980, the total contributions to the retirement system or plan shall be sufficient to meet the normal cost of the retirement system or plan and to amortize the unfunded liability, if any, within 40 years; however, nothing contained in this subsection permits any retirement system or plan to amortize its unfunded liabilities over a period longer than that which remains under its current amortization schedule.
  - (3) For a retirement system or plan which comes into existence after October 1, 1980, the unfunded liability, if any, shall be amortized within 40 years of the first plan year.
- < The reference to 40 years is historical. All current and future unfunded liabilities shall be amortized within 30 years. >
- (4) The net increase, if any, in unfunded liability under the plan arising from significant plan amendments adopted, changes in actuarial assumptions, changes in funding methods, or actuarial gains or losses shall be amortized within 30 plan years.
  - (5)
    - (a) If the amortization schedule for unfunded liability is to be based on a contribution derived in whole or in part from a percentage of the payroll of the system or plan membership, the assumption as to payroll growth shall not exceed the average payroll growth for the 10 years prior to the latest actuarial valuation of the system or plan unless a transfer, merger, or consolidation of government functions or services occurs, in which case the assumptions for payroll growth may be adjusted and may be based on the membership of the retirement plan or system subsequent to such transfer, merger, or consolidation.
    - (b) An unfunded liability amortization schedule that includes a payroll growth assumption and is in existence on September 30, 1996, or is established thereafter, may be continued using the same payroll growth assumption, or one not exceeding the payroll growth assumption established at the start of the schedule, regardless of the actual 10-year average payroll growth rate, provided that:

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1. The assumptions underlying the payroll growth rate are consistent with the actuarial assumptions used to determine unfunded liabilities, including, but not limited to, the inflation assumption; and
  2. The payroll growth rate is reasonable and consistent with future expectations of payroll growth.
- (c) An unfunded liability amortization schedule that does not include a payroll growth assumption and is in existence on September 30, 1996, or is established thereafter, may be continued or modified to include a payroll growth assumption, provided that such assumption does not exceed the 10-year average payroll growth rate as of the actuarial valuation date such change in the amortization schedule commences. Such schedule may be continued thereafter, subject to the reasonable and consistent requirements in paragraph (b).

**112.66 General provisions.**

- (13) A local government sponsor of a retirement system or plan may not reduce contributions required to fund the normal cost. This subsection does not apply to state-administered retirement systems or plans.



**City of Hollywood General Employees' Retirement System**  
**Actuarial Funding Policy**  
**Adopted: XXXX Y, 2016**

**Portions of Funding Policy Established By Board of Pension Trustees:**

**1. Current Policy**

**Actuarial Cost Method**

The Board of Pension Trustees has adopted the use of the Entry Age Normal actuarial cost method to determine annual contribution requirements for the Plan. It is also the funding method required under GASB Statements No. 67 and No. 68.

**Entry Age Normal**

Under the Entry Age Normal Actuarial Cost Method, an annual level normal cost is calculated for each individual active member, payable from the date of employment to the date of retirement, that is sufficient to accumulate to the value of the member's benefit at the time of decrement/retirement. Each annual normal cost is calculated as a constant percentage of that member's year by year projected covered pay.

Under this method, actuarial experience gains (losses) are explicitly recognized each year as they occur. They reduce (increase) the Unfunded Actuarial Accrued Liability (UAAL), and they are amortized separately.

Changes in the UAAL due to actuarial experience gains and losses, amendments, and changes in actuarial assumptions or methods are recognized in the UAAL and amortized over a reasonable period of future years.

**Asset Valuation Method**

The Board of Pension Trustees has adopted an asset valuation method that recognizes 20% of the difference between the actual investment return based on the market value of assets and the expected investment return based on the actuarial asset value.

The Actuarial Value of Assets is based on the market value with investment gains and losses smoothed over five years. The Actuarial Value of Assets will not consistently be above or below the Market Value and is expected to converge to the Market Value in a relatively short period of time. At any time it may be either greater or less than Market Value. During periods when investment performance exceeds the assumed rate, the Actuarial Value of Assets will tend to be less than Market Value. During periods when investment performance is less than the assumed rate, the Actuarial Value of Assets will tend to be greater than Market Value. If assumed rates are exactly realized for five consecutive years, the Actuarial Value will become equal to Market Value.

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**Adopted: XXXX Y, 2016**

The Actuarial Value is limited to a 20% corridor around the Market Value. This means that if the preliminary development of the Actuarial Value results in an amount that is greater than 120% of the Market Value (or less than 80% of the Market Value), the final Actuarial Value is limited to 120% (or 80%) of the Market Value. Any gains or losses on the Market Value outside of the 20% corridor are therefore recognized immediately.

**Amortization Method**

The Board of Pension Trustees has adopted a 30-year closed amortization period for changes in the Unfunded Actuarial Accrued Liability caused by plan changes, actuarial assumptions changes, method changes and actuarial experience gains and losses. For amendments that apply to inactive members only, the amortization period shall be determined based on the average expected remaining lifetime of the inactive members affected by the amendment.

Amortization bases may also be combined to reduce volatility in the required employer contributions if adopted by the Board of Pension Trustees based upon the advice and recommendation of the Plan's actuary. Amortization bases will be combined, in accordance with the methodology described for combining and offsetting amortization bases under Internal Revenue Code Section 412(b), if the sum of the outstanding bases is positive while the sum of the amortization payments is negative, or vice versa.

**Actuarial Assumptions**

The Board of Pension Trustees requires the actuary to perform an actuarial investigation into the experience of the Plan every five years to form the basis for recommendations for changes in the actuarial assumptions.

**Funding Target**

The Board of Pension Trustees' funding objective is to achieve and maintain at least 100% funding. For this purpose, "100% funding" means that the Actuarial Value of Assets equals the Actuarial Accrued Liability. The amortization method allows up to 30 years to achieve this objective.

**Risk Management**

The main financial objective of this actuarial funding policy is to fund the long-term costs of benefits to plan members and beneficiaries. There are numerous risks that the Plan faces in trying to achieve this objective including funding risk, demographic risk, investment risk, and benefit risk. The Board policies for managing these risks are outlined in this section.

*Funding Risk*

*Frequency of Actuarial Valuations – The Board of Pension Trustees will request an actuarial valuation report every year.*

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Regular valuations manage funding risk by allowing employer contribution rates to reflect actual experience as it emerges. Funding valuations are performed every year as of October 1 to determine employer contribution amounts for the fiscal year beginning nine months later.

Separate valuations are required for financial reporting under GASB 67 and 68.

*Demographic and Investment Risk*

*Process for Reviewing and Updating Actuarial Assumptions - The Board of Pension Trustees requires the actuary to perform an actuarial investigation into the experience of the Plan every five years to form the basis for recommendations for changes in the actuarial assumptions.*

Demographic and investment risks may be managed in part by having regular reviews of the actuarial assumptions. The City Ordinance requires the actuary to perform an actuarial investigation into the experience of the Plan every five years. Once in receipt of the experience study report, the Board will adopt actuarial assumptions and methods as necessary. If circumstances warrant, the Board may change assumptions more frequently after conferring with the actuary and when investment risks are involved, the investment consultant.

The experience study report shall include, but not necessarily be limited to, analysis of and recommendations regarding the following assumptions:

- i. Pre-retirement withdrawal rates
- ii. Retirement rates
- iii. Disability rates
- iv. Pay increase rates
- v. Investment returns considering both real return and inflation, which must be consistent with the investment policy

The experience study report will serve as the basis for determinations by the Board regarding whether or not demographic or economic assumptions should be modified for future valuations.

Chapter 112.661 (9), Florida Statutes specifies the investment policy adopted by the Board must include a requirement that the Board shall determine the total expected annual rate of return for the current year, for each of the next several years, and for the long term thereafter. This determination must be filed promptly with the Department of Management Services and with the plan's sponsor and the consulting actuary.

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*Risk Measures*

In order to quantify the risks outlined in this actuarial funding policy, certain risk metrics will be monitored. Some of the risk measures that will be monitored are as follows:

- i. Funded ratio (Actuarial Value of Assets divided by Actuarial Accrued Liability).
  - Measures progress towards the funding objective of the 100% target funded ratio.
- ii. Total Actuarial Accrued Liability (AAL) divided by Total Payroll
  - Measures the risk associated with the ability to respond to liability experience through adjustments in contributions. A decrease in this measure indicates a decrease in liability experience risk. This also provides a long-term measure of the asset risk in situations where the Plan has a funded ratio below 100%.
- iii. Total Market Value of Assets divided by Total Payroll
  - Measures the risk associated with the ability to respond to asset experience through adjustments in contributions. A decrease in this measure indicates a decrease in asset experience risk.
  - A high ratio equates to high contribution rate volatility due to investment experience.
- iv. Ratio of Actuarial Value of Assets to Market Value of Assets
  - A ratio of more than 1 indicates there are unrecognized investment losses.
  - A ratio of less than 1 indicates there are unrecognized investment gains.

*Benefit Risk*

Benefit risk may be managed as follows:

The Board shall review proposals and legislative changes for the potential legal, administrative, Internal Revenue Code compliance, and funding impact on the Fund. If a proposal has the potential for a meaningful impact on plan funding, the Board shall consult with the actuary to estimate the actuarial impact to the Plan.

The Board does not establish the benefit provisions; it administers them.

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**Miscellaneous Matters Associated with Funding:**

**Overall Conformance with Professional Standards of Practice**

By law, the actuary shall be an Enrolled Actuary and either a Member of the American Academy of Actuaries or an Associate or a Fellow of the Society of Actuaries. The work of the actuary in connection with this policy shall conform to Actuarial Standards of Practice for public employee retirement plans promulgated by the Actuarial Standards Board and shall satisfy the requirements of the Governmental Accounting Standards Board with respect to the development of information needed by the Plan and by the City for financial reporting purposes.

**DRAFT**

# **GRS** Research Report

Gabriel Roeder Smith & Company

## **Developing a Pension Funding Policy for State and Local Governments**

By David Kausch and Paul Zorn<sup>1</sup>

Over the past decade, the Annual Required Contribution (ARC) as described in the Governmental Accounting Standards Board's (GASB's) Statements No. 25 and No. 27 has become a de facto funding policy for many public-sector retirement systems. The GASB is currently revising public pension accounting standards and has communicated an important message in the process: accounting standards are not funding standards. In the Exposure Drafts (EDs) of the new Statements No. 25 and No. 27, the GASB has removed all references to the ARC. At the same time, the EDs require disclosure of elements of a plan's funding policy and the actual funding pattern must be taken into account to determine the plan's financial disclosures. Now more than ever, public retirement systems need to have a sound, written funding policy to secure member benefits – and a strong funding policy may improve a plan's financial disclosures as well.

### **Funding Policy Goals**

The idea of having a written funding policy is not new. In its Best Practice, "Sustainable Funding Practices of Defined Benefit Pension Plans," the Government Finance Officers Association (GFOA) states that the main financial objective of public employee defined benefit plans is to fund the long-term costs of promised benefits to plan participants.<sup>2</sup> Moreover, the GFOA recommends that this be done through a systematic and disciplined accumulation of resources (i.e., contributions and related investment earnings) which are sufficient to the pay promised benefits to plan members over their lifetimes.

In addition to this objective, the GFOA's Best Practice cites other goals as well. To be consistent with the governmental budgeting process, efforts should be made to keep the employer's pension contributions relatively stable from year to year. Moreover, to satisfy the principle of intergenerational equity, pension costs should be allocated to taxpayers on an equitable basis over time, i.e., not pushed into the future or immediately imposed on current taxpayers. In addition, to help offset related risks, efforts may be made to provide a reasonable margin for adverse experience. Developing a written funding policy can help decision-makers understand the tradeoffs related to reaching these goals and document the reasoning that underlies their decisions. By clarifying the funding policy, decision-makers can come to a better understanding of the principles and practices that help sustain benefits over the long-term.

### **Risk-Management Framework**

These funding principles can be thought of in a risk-management framework. In an effort to keep the employer's pension contribution relatively stable from year to year, a funding policy should: (1) identify key

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<sup>1</sup> David Kausch is chief actuary for GRS and Paul Zorn is director of governmental research. The authors thank Brian Murphy, Theora Braccialarghe, Supriya Kopf, Lewis Ward, Danny White, Dana Woolfrey and Mary Ann Vitale at GRS for their thoughtful comments. However, the authors retain full responsibility for the accuracy of the information. Moreover, the views expressed do not necessarily represent those of GRS as an organization.

<sup>2</sup> Government Finance Officers Association, "Sustainable Funding Practices for Defined Benefit Pension Plans," 2009.

risk areas that add to contribution volatility and (2) identify ways to manage each of those risks. The primary risk areas in funding retirement systems are investment risks, demographic risks within the covered population, benefit or plan design risks, and governance risks. In response to this:

- Investment risks can be managed with diversification of asset classes and asset smoothing.
- Demographic risks can be measured and managed through the use of regular actuarial valuations and actuarial experience studies.
- Benefit or plan design risks are often outside the purview of a retirement system's board, but may include setting the interest rate on member contributions and deciding when to provide ad-hoc COLAs or thirteenth checks.
- Governance risks can be managed with clear policies and controls regarding the major administrative practices of the retirement system.

A written funding policy addresses all of these risks and recognizes tradeoffs between mitigating contribution volatility and recognizing gains and losses over a reasonable period. To help decide these tradeoffs and document the reasoning behind the decisions, the GFOA's Best Practice recommends that plans adopt a written pension funding policy describing the principles and practices that guide the funding decisions. These would include: (1) the reasons for selecting the actuarial methods and assumptions, and (2) the policies related to risk sharing and responding to changes in plan experience. Key elements of a funding policy include decisions related to:

- Actuarial cost method and assumptions
- Asset valuation method
- Amortization method
- Funding target
- Risk management regarding:
  - Frequency of actuarial valuations,
  - Process for reviewing and updating actuarial assumptions,
  - Responding to legislative proposals and changes,
  - Responding to favorable/unfavorable investment experience,
  - Sensitivity analysis and forecasting, and
  - Asset/Liability modeling.

### **Elements to Consider in Developing a Funding Policy**

#### **Actuarial Cost Method**

Different actuarial cost methods produce different patterns of normal costs and actuarial accrued liabilities. Some actuarial cost methods are more useful for determining contributions to an ongoing plan, and some are more useful for closed plans. While a detailed description of each cost method is beyond the scope of this report, the following three methods illustrate key distinctions. A more detailed discussion of actuarial cost methods is presented in Appendix A.

- Traditional Unit Credit (TUC) – Under this actuarial cost method, the normal cost for a given year reflects the increase in the benefit earned due to increases in service and salary for the year, but not to service and salary projected to be earned in future years. Generally, this method is not used to fund ongoing public pension plans.
- Projected Unit Credit (PUC) – Under this method, normal cost is calculated using benefits based on increases in service for the year, but with salary projected to the retirement date. This method is used by about 10% of public pension plans.

- Entry Age Normal (EAN) – Under this method, normal cost is calculated using benefits based on projected service and salary at retirement and is allocated over an individual's career as a level percent of payroll. This method is used by about 75% of public pension plans.

Funding policy issues related to the actuarial cost method include:

- Is the cost method appropriate for the plan?
- Does the cost method produce normal costs that are reasonably stable and therefore consistent with the government's budgeting process?

For ongoing plans, the popularity of the EAN cost method is not surprising given governments' need to limit volatility in contribution rates. Moreover, since contribution rates are initially higher under the EAN method than other cost methods, the EAN method accumulates assets more quickly than the other methods. As a result, the assets can be invested earlier to help offset future contributions. By contrast, the TUC and PUC methods start with lower contributions which increase over time.

For closed plans, other actuarial cost methods may be more appropriate. The lack of new entrants into the plan and the shorter service lives of the remaining active members may make it appropriate to fund the plan more rapidly than under the EAN method. This could be done using the Aggregate actuarial cost method. The Aggregate cost method allocates the difference between the value of benefits and assets over the future service of the closed active population as a level percent of payroll.

### **Actuarial Assumptions**

Actuarial assumptions also play a key role in determining the plan's normal costs and actuarial accrued liabilities. The assumptions can be categorized into two groups: (1) economic assumptions (including inflation, wage growth, and long-term expected investment returns); and (2) demographic assumptions (including rates of mortality, disability, retirement, and termination). All assumptions should be consistent with Actuarial Standards of Practice and reflect professional judgment regarding future outcomes.

Although all assumptions are important, the investment return assumption plays an extremely important role in the actuarial valuation, and strongly influences the calculations of normal costs and actuarial accrued liabilities. For funding purposes, the Actuarial Standards Board's Actuarial Standards of Practice (ASOP) No. 27 supports the use of discount rates based on the plan's long-term expected investment return.<sup>3</sup> Funding policy issues related to the discount rate include:

- Does the long-term expected investment return accurately reflect likely investment returns?
- What variations in the actual investment return will likely occur over the long-term?

In order for the actuarial valuation to properly fund the benefits, it is important that the discount rate accurately reflect the long-term investment return. If the assumption is too high, the contributions and actuarial liabilities determined by the valuation will be too low. If the assumption is too low, the contributions and actuarial liabilities will be too high. It is also important to understand that the assumption is intended to reflect an average expected return. In given years, actual returns will vary from the expected return.

<sup>3</sup> Actuarial Standards Board, ASOP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*, May 2011.



## Asset Valuation Method

The actuarial methods that are used to determine the plan's actuarial value of assets (AVA) also play a role in the funding policy. The difference between the actuarial accrued liability (AAL) and the AVA is the plan's unfunded accrued liability (UAL). To the extent that the plan has a UAL, it must be amortized and included in the contribution rate. Key funding policy issues related to asset valuations include:

- Should the actuarial value of assets be smoothed? If so, over what period?
- Should a corridor be applied to the smoothed value of assets to prevent it from diverging too far from the market value?

**Smoothed vs. Market Value of Assets.** Investment gains and losses are often "smoothed" into the AVA in order to mitigate the impact of investment volatility on employer contributions. In many cases, this is done by taking the difference between the actual annual investment earnings and the expected annual investment earnings and recognizing a portion of that difference each year over a set number of years. This evens out the impact of investment gains and losses that would otherwise be immediately recognized in the UAL.

**Smoothing Period.** In cases where assets are smoothed, the smoothing period is often 5 years, although some plans use shorter or longer periods. While the smoothing period for governmental plans is not limited by federal laws or regulations, the Actuarial Standards Board has set out principles for asset smoothing in ASOP No. 44.<sup>4</sup> Under these principles, when a smoothed asset valuation method is used, the actuary should select a method so that:

- The smoothed asset values fall within a reasonable range of the corresponding market values; and
- Any differences between the actuarial value and market value of assets should be recognized within a reasonable period.

**Asset Corridors.** To satisfy these principles, many plans that smooth assets over periods longer than 5 years also include corridors that limit the extent to which the smoothed value of assets can diverge from the market value. Appendix B provides an illustration of how asset smoothing and asset corridors interact.

## Amortization Method

In addition to the normal cost, the other major component of the annual contribution is the portion needed to amortize the UAL. Consequently, when setting the funding policy, the structure of the amortization payments and the length of the amortization period are important issues. It should also be noted that during the amortization period, interest accrues on the outstanding UAL at a rate reflecting the long-term expected investment return. In setting up an amortization policy, the following decisions should be made:

- Should the amortization period be open or closed?
- Should the amortization be on a level-dollar basis or a level-percent-of-pay basis?
- What should be the length of the amortization period?
- Should there be separate amortization bases for annual gains/losses, benefit changes, and other components of the UAL?

A key issue in setting the amortization policy is the possibility of negative amortization. This occurs when the amortization payments are less than the interest accrued on the UAL during the year, and so the outstanding UAL increases rather than decreases. However, this depends on the length of the amortization period, as well as assumptions related to expected investment return and payroll growth. It is important to

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<sup>4</sup> Actuarial Standards Board, ASOP No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, May 2011.

note that while the UAL increases when there is negative amortization, it is typically not expected to increase faster than the projected rate of payroll growth and is expected to be fully paid by the end of the period. However, an open amortization period which allows negative amortization may be inconsistent with reaching a funding target of 100% in a reasonable period of time.

***Closed Amortization vs. Open Amortization.*** Another issue is whether the UAL should be amortized over a closed amortization period or an open amortization period. If a closed amortization period is used, the UAL will be fully paid by the end of the period. By contrast, under an open amortization period, the period is reset each year. For example, under a 25-year open amortization period, the UAL is refinanced each year over a new 25-year period.

Closed amortization periods pay down the UAL more rapidly and limit negative amortization, but produce more volatility in the contribution rate as the period gets shorter. An open period results in a more gradual decline of the UAL and helps to control volatility in the contribution rate, but takes substantially longer to pay down the UAL. Moreover, an open amortization period is more likely to produce negative amortization, at least when the period is 15 to 20 years or longer. Appendix C provides illustrations of the amortization patterns under closed and open amortization periods.

***Level-dollar vs. Level-percent-of-pay.*** Another issue is whether the UAL should be amortized on a level-dollar basis or as a level-percent-of-pay. Level-dollar amortization is similar to a fixed-rate home mortgage with a constant dollar payment. Level-percent-of-pay amortization initially has lower dollar payments, but these increase each year. Since level-dollar amortization pays a greater portion of the UAL in earlier years, it is more conservative than level-percent-of-pay amortization. However, level-percent-of-pay-amortization may be more consistent with the budgeting process of most governmental entities.

***Length of the Amortization Period.*** Generally, for public pension plans, amortization periods range from 15 to 30 years, although some plans use shorter or longer periods. Shorter amortization periods result in the UAL being paid off sooner, but require higher and likely more volatile contributions. Longer amortization periods require lower contributions, but may shift some of the pension costs beyond the working careers of active employees and on to future generations.

***Single Amortization vs. Separate Amortization Bases.*** So far the discussion of amortization has focused on amortizing the UAL as a whole over a single amortization period. This approach is straightforward, since there would be no need to track separate amortization bases. However, the UAL is made up of amounts that come from different sources, including: (1) actuarial gains and losses due to differences between actual and assumed plan experience, (2) benefit changes, and (3) changes in actuarial methods and assumptions. As a result, the plan may wish (or in some cases be required) to amortize the UAL from these sources over different periods. For example, changes in the UAL due to benefit changes could be amortized over a shorter period than changes in the UAL due to changes in actuarial assumptions. However, a disadvantage to using multiple amortization periods is that they may increase the volatility of contribution rates.

## **Funding Target**

The funding target is the funded ratio that the plan is trying to reach and maintain through its funding policy. The GFOA's Best Practice "Sustainable Funding Practices for Defined Benefit Pension Plans" recommends a funding target of 100%. Setting the funding target to anything other than 100% means establishing a policy of making contributions that are greater or less than the amounts theoretically needed to fund the plan. However, funding targets of more than 100% may provide a margin for adverse experience. On the other hand, funding targets of less than 100% may help mitigate pressure for benefit increases.

## **Risk Management**

As noted at the beginning of this report, there are a variety of risks associated with defined benefit plans, including investment risks, demographic risks, benefit design risks, and governance risks. To manage the risks, it is important to first identify the potential impact of a specific risk on plan funding, and then to identify ways to manage the risk. Pension funding policy should include a discussion of the steps needed to monitor and address the risks facing the plan.

Investment risks involve both the risks that investment returns will not meet actuarial expectations and that the volatility of the returns will make contribution rates difficult to budget. Generally, investment risks are managed through changes in asset allocations which, in turn, are based on asset allocation studies and asset/liability analyses. If changes are made to asset allocations, the long-term investment return assumption should also be reviewed and, if necessary, changed to reflect the new asset allocation.

Demographic risks involve the risks that the plan's actual experience related to mortality, retirement patterns, and other demographic factors do not match the actuarial assumptions. It is considered best practice to do experience studies at 5-year intervals to monitor and update the assumptions.

Benefit design risks include the risks that benefit changes will result in future contributions that are unaffordable for the sponsoring government. One way to examine these risks is to have an actuarial valuation of the benefit changes done before the changes are approved by the government, an approach recommended by the GFOA. Benefit design risks can also be examined using stochastic projections that compare future benefits with future contributions and investment returns, as well as scenario (stress) tests which examine changes in funding that result from specific changes in assumptions.

Changes in benefits may require a change in actuarial assumptions. For example, it may be necessary to lower the investment return assumption if benefit increases are based on favorable investment experience (i.e., actual investment returns that are higher than expected returns). As discussed in the section on actuarial assumptions above, the long-term investment return assumption reflects the actuary's estimate of the average return. Using excess earnings rather than additional contributions to provide increased benefits reduces the earnings available to pay current benefits. This, in turn, may require a lower investment return assumption be used, thereby increasing the actuarial accrued liability of the plan. Similarly, when investment gains result in lowered contributions, care should be taken to ensure the contributions do not fall to unreasonable levels.

Governance risks relate to the risks that the plan's administrative policies and procedures are appropriate for carrying out the functions of the plan. Funding policy can address governance risks by discussing the administrative structures that should be in place for monitoring compliance with the funding policy and ensuring that the actuarially determined contributions are made. In addition, funding policy can help ensure that the long-term costs of benefit changes are determined before legislative action is taken.

## **Conclusion**

In funding defined benefit pension plans, governments must satisfy a range of objectives. In addition to the fundamental objective of funding the long-term costs of promised benefits to plan participants, governments also work to: (1) keep employer's contributions relatively stable from year to year; (2) allocate pension costs to taxpayers on an equitable basis; and (3) manage pension risks.

Developing a written funding policy can help decision-makers understand the tradeoffs involved in reaching these goals and document the reasoning that underlies their decisions. By clarifying the funding policy, decision-makers can come to a better understanding of the principles and practices that produce sustainable benefits.

### Summary of Funding Policy Elements

Element	Policy Function	Issues to Address
Actuarial Cost Method	Determines accrual patterns of normal costs and actuarial accrued liabilities	<ul style="list-style-type: none"> <li>Is the actuarial cost method appropriate for the plan?</li> <li>Does the cost method produce normal costs that are reasonable stable and consistent with the budgeting process?</li> </ul>
Actuarial Assumptions	Determines the assumptions used in the actuarial valuation and other studies	<ul style="list-style-type: none"> <li>Does the long-term expected investment return accurately reflect likely investment returns?</li> <li>How will actual investment returns likely vary from the assumed return over time?</li> <li>Do the demographic assumptions, including the mortality assumptions, accurately reflect the ongoing experience of the plan?</li> <li>How often should studies be done to evaluate the actuarial assumptions?</li> </ul>
Asset Valuation Method	Determines the actuarial value of assets and, by extension, the unfunded accrued liability	<ul style="list-style-type: none"> <li>Should the actuarial value of assets be smoothed? If so, over what period?</li> <li>Should an asset corridor be applied to prevent the smoothed value of assets from diverging too far from the market value?</li> </ul>
Amortization Method	Determines the portion of the unfunded accrued liability that is amortized in the contribution rate each year	<ul style="list-style-type: none"> <li>Should the amortization period be open or closed?</li> <li>Should it be on a level-dollar basis or level-percentage-of-pay basis?</li> <li>What should be the length of the amortization period?</li> <li>Should there be separate amortization bases for different components of the unfunded accrued liability?</li> </ul>
Funding Target	Determines the funded ratio targeted by the funding policy	<ul style="list-style-type: none"> <li>Should the funding target be other than 100%?</li> </ul>
Risk Management	Aligns the funding policy with the risk management framework	<ul style="list-style-type: none"> <li>How should risks be monitored with regard to investments, demographics, and plan design?</li> <li>What actions should be taken to address the risks?</li> <li>How should favorable investment experience be treated?</li> <li>How should unfavorable investment experience be treated?</li> </ul>
Governance	Monitors plan administration and contributions	<ul style="list-style-type: none"> <li>What administrative structures should be in place to monitor compliance with the funding policy and ensure actuarially determined contributions are made?</li> <li>What governance structures should be in place so that the long-term costs of benefit changes are determined before legislative action is taken?</li> </ul>

## Appendix A – An Overview of Actuarial Cost Methods

In order to make sound decisions related to pension funding, it is important to understand how the actuarial cost methods work and how the employer's actuarially determined contributions are calculated.

### Present Value of Future Benefits

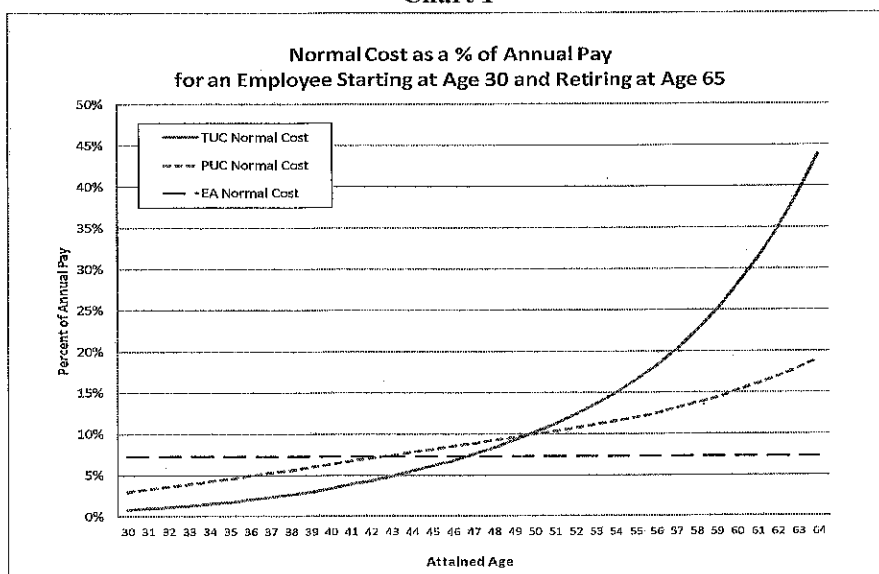
To determine the contributions needed to fund the plan, the value of benefits to be paid in the future must be converted to amounts as of the valuation date. This is done by projecting the future benefits owed to current plan members based on the plan's benefit provisions and actuarial assumptions. These projected future benefits are then discounted using a rate that represents the expected long-term rate of investment return on plan assets. The resulting "projected value of future benefits" (PVFB) is the sum of the discounted values of the projected benefits. Essentially, this is the amount on the valuation date which, if invested at the discount rate, would pay all of the projected future benefits (provided the actuarial assumptions are met).

### Normal Cost

An individual's normal cost is the portion of the PVFB that is allocated to a given year of employee service under the actuarial cost method. The plan's total normal cost in a given year is the sum of each individual's normal cost for that year.

There are a variety of actuarial cost methods and different methods take different approaches to allocating the normal cost over an individual's career. Chart 1 illustrates how normal costs vary under three actuarial cost methods: the Traditional Unit Credit (TUC) method, the Projected Unit Credit (PUC) method, and the Entry Age Normal (EAN) cost method. The three lines show the normal cost patterns for an individual employee who begins coverage under the plan at age 30 and retires at age 65, assuming the same benefit and same assumptions. The normal costs are shown as a percent of annual pay.

Chart 1

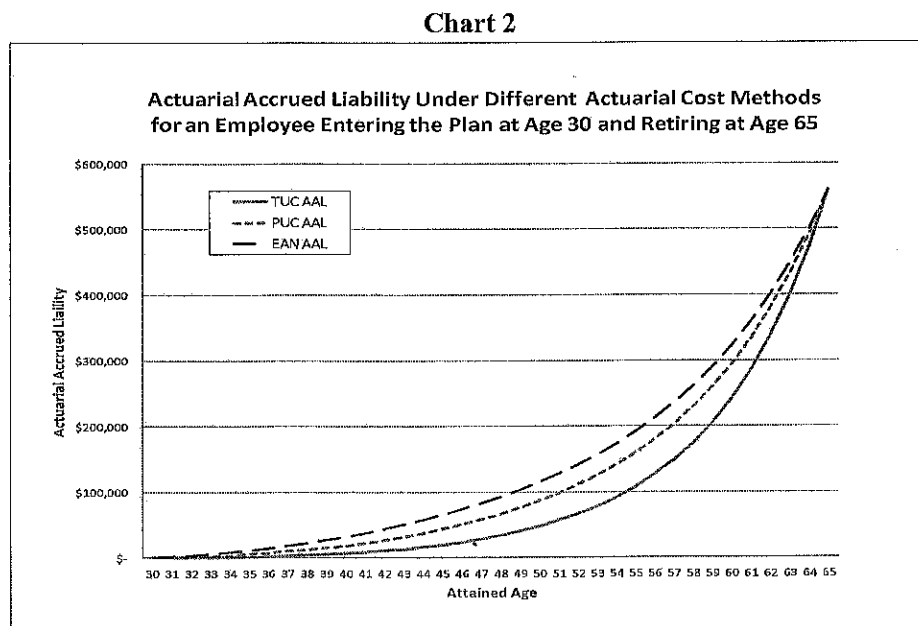


- The TUC method recognizes salary and years of service in the benefit only when earned. As a result, normal costs under this method increase at an accelerating rate as the employee approaches retirement age and as salary increases.

- The PUC method recognizes years of service when earned, but projects salary to retirement age. As a result, normal costs also increase under this method as an employee approaches retirement, but at a slower rate than under the TUC because future increases in salary are recognized in advance.
- The EAN cost method immediately recognizes both projected salary and service. As a result, it allows normal costs to be calculated as a level-dollar amount or as a level-percent-of-pay over the employee's career.

### Actuarial Accrued Liability

The actuarial accrued liability (AAL) is the accumulated amount of the normal costs attributed to years of service before the valuation date. Given that the different actuarial cost methods result in different normal costs, it follows that they also result in different accrual patterns for the AAL over a member's employment. Chart 2 shows the accrued AAL for an individual employee who begins coverage under the plan at age 30 and retires at age 65. As with Chart 1, the three lines reflect the different actuarial costs methods applied to the same employee earning the same benefit under the same assumptions.



Since the employee will receive the same benefit at retirement, the actuarial cost methods converge to the same actuarial accrued liability. However, the paths they take are different.

- Under the TUC method, the AAL starts out low and increases over time as each year's accumulating salary and years of service are recognized in the AAL. Much of the AAL under the TUC is accrued in the last 5 years before retirement.
- Under the PUC method, the AAL increases somewhat more rapidly than under the TUC, but the PUC method still shifts recognition of much of the AAL toward the end of the employee's career.
- Under the EAN cost method, a larger portion of the AAL is recognized in earlier years, which in turn, helps provide for more level contribution rates over the employee's career.

Note that Chart 2 shows only the liability accrual pattern for one employee over time. The accrual pattern for the plan as a whole will depend on the age and service characteristics of all employees in the plan.

## Appendix B – An Example of Asset Smoothing and Asset Corridors

As discussed in the report, investment gains and losses are often “smoothed” into the actuarial value of assets (AVA) in order to mitigate the impact of investment volatility on contributions. While most public plans use 5-year smoothing periods, plans that smooth over longer periods often use asset corridors to limit the extent to which the value of smoothed assets can diverge from the market value.

For example, under an “80/120” corridor, the smoothed value of assets is not allowed to fall below 80% or rise above 120% of the market value. This helps keep the actuarial value of assets within a reasonable range of the market value. However, during a major market decline or increase, the smoothed value of assets may exceed the corridor. If so, the amount of assets exceeding the corridor must be immediately recognized, adding to the volatility of the UAL and contributions.

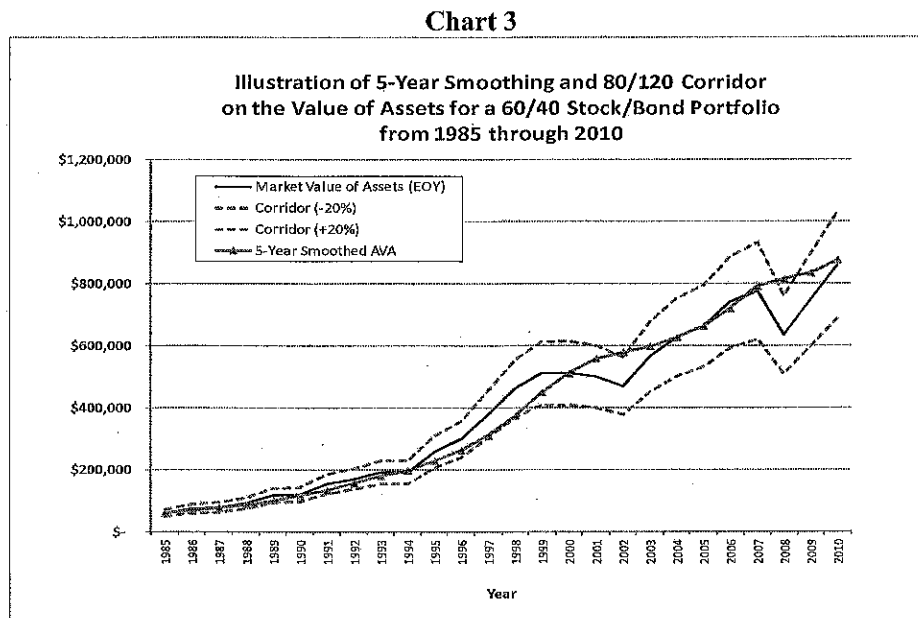


Chart 3 shows the growth of a hypothetical plan’s investment portfolio with a 60% mix of large cap stocks and a 40% mix of high-quality corporate bonds over the period from 1985 to 2010. The solid black line shows the market value of assets (MVA) at calendar year-end and the gray dotted lines show the 80/120 corridor boundaries. The green line (marked with triangles) shows the 5-year smoothed AVA.

Several things are interesting about the chart. First, during most of the 1990s, the 5-year smoothed AVA was below the MVA. This is because actual investment returns were substantially higher than expected returns for most of the decade, and the MVA outpaced the AVA. In fact, the 5-year smoothed AVA was very close to the 80% corridor in 1997 and 1998.

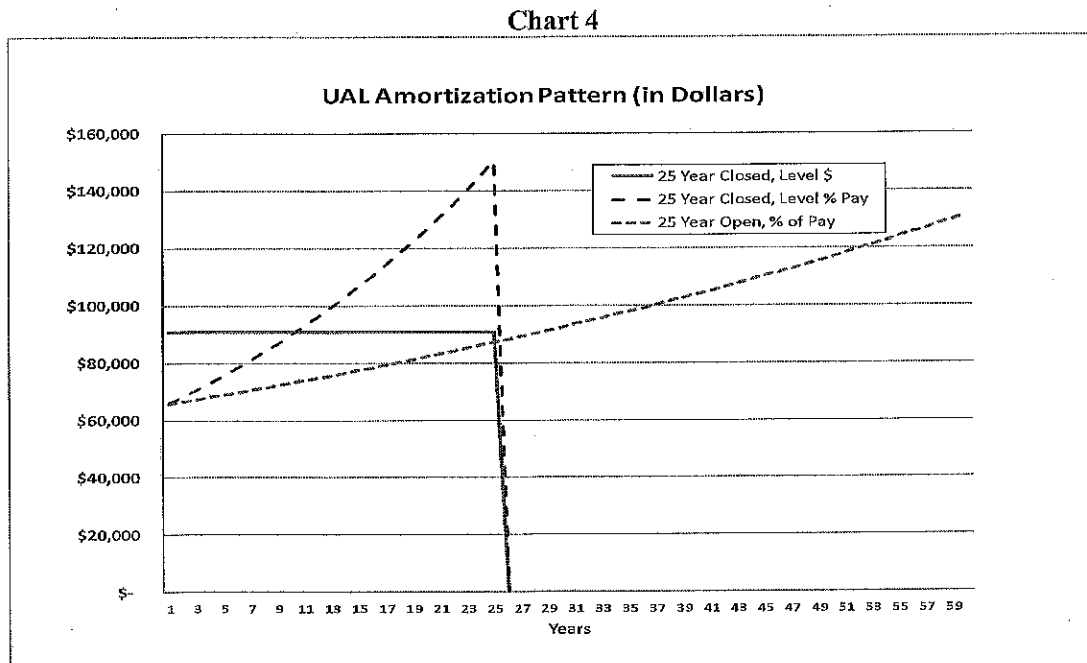
When the financial markets declined during 2000-2002, the 5-year smoothed AVA continued increasing, due to continued recognition of gains from the 1990s. When the financial markets picked up again in 2003, the asset losses from 2000-2002 offset part of the asset gains and the 5-year smoothed AVA moved closer to the MVA. However, the financial crisis of 2008 caused the MVA to decline sharply, causing a similar fall in the corridor boundaries. Consequently, in 2008, the 5-year smoothed AVA would have been greater than the upper boundary of the corridor. If the corridor had been in place, the plan would have had to lower its AVA to match the corridor’s upper boundary, increasing its UAL and the amount of the UAL amortized in its contribution rate.

## Appendix C: Amortization Patterns under Closed and Open Periods

An important pension funding policy issue is whether the UAL should be amortized over a closed amortization period or an open amortization period. Closed amortization periods pay down the UAL more rapidly and limit negative amortization, but produce more volatility in the contribution rate as the period gets shorter. Open amortization periods help control volatility in the contribution rate, but take longer to pay down the UAL.

Another amortization issue is whether the UAL should be amortized on a level-dollar basis or as a level-percent-of-pay. Level-percent-of-pay amortization initially has lower dollar payments, but these increase each year. Since level-dollar amortization pays a greater portion of the UAL in earlier years, it is more conservative than level-percent-of-pay amortization. However, level-percent-of-pay-amortization is more consistent with the budgeting process of most governmental entities.

Chart 4 shows the UAL amortization patterns for: (1) a 25-year closed level-dollar amortization approach; (2) a 25-year closed level-percent-of-pay approach; and (3) a 25-year open percent-of-pay approach. The amortization payments are expressed in dollars.

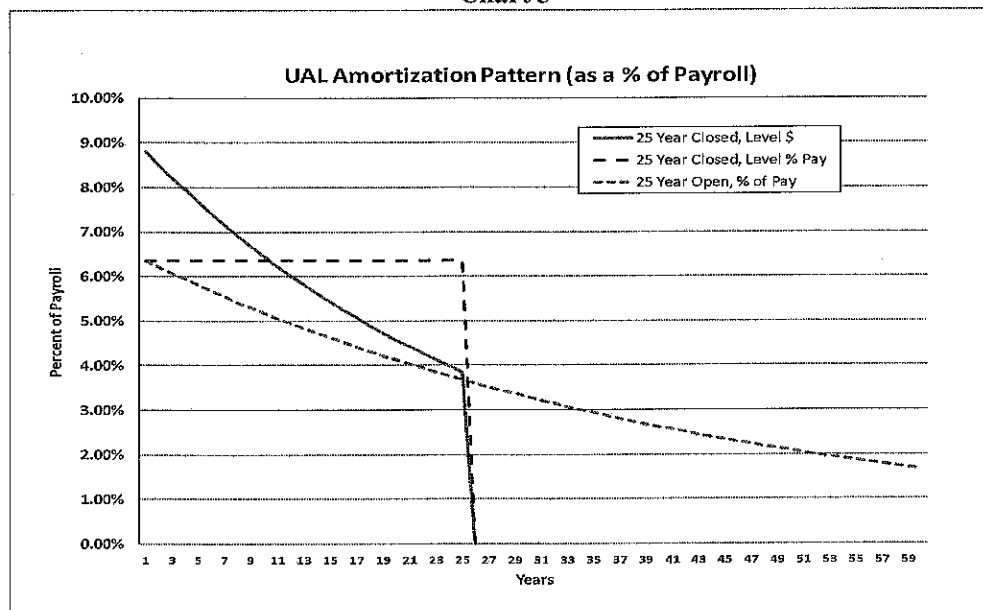


- Under the closed, level-dollar approach, the dollar payments start higher than under the level-percent-of-pay approaches, and remain level until the end of the amortization period, at which time the UAL is completely amortized.
- Under the closed, level-percent-of-pay approach, the dollar payments are initially below the payments made under the level-dollar approach, but exceed the level-dollar payments after approximately 10 years, and ultimately become substantially more than the payments under the level-dollar approach.
- Under the open percent-of-pay approach, the dollar payments start at the same amount as the closed, level-percent-of-pay approach, and remain below the dollar payments under the closed approach. However they continue to increase even after the end of the 25-year period and may continue for several decades.



The dynamics appear different when the same amortization payments are expressed as a percentage of covered payroll, as in Chart 5:

Chart 5



From this perspective, the closed level-dollar payments decline rapidly as a percent of payroll. Under the closed level-percent-of-pay approach the payments remain level until they are fully amortized at the end of the period. However, under the open percent-of-pay approach, the amortization payments extend beyond the 25-year period and continue to decline for decades thereafter. The rate at which they fall depends on a number of factors, including the expected investment return and payroll growth assumption.

**ITEM 7.b.**

**OCTOBER 1, 2015  
ACTUARIAL VALUATION  
REPORT**

**(Backup will be provided at meeting)**

## **AGENDA ITEM 8**

**NO BACKUP  
FOR THIS SECTION**

## **AGENDA ITEM 9**

**NO BACKUP  
FOR THIS SECTION**

## **AGENDA ITEM 10**

**CITY OF HOLLYWOOD, FLORIDA  
PENSION COORDINATOR  
MEMORANDUM TO THE PENSION BOARD**

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**DATE:** March 9, 2016  
**TO:** Board of Trustees of the Employees' Retirement Fund  
**FROM:** Lisa Castronovo, Pension Coordinator *lcc*  
**SUBJECT:** Pension Coordinator Report

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**ISSUE:**

Items of interest from the Pension Coordinator

**EXPLANATION:**

- 1) In 2015, the National Conference on Public Employee Retirement Systems (NCPERS) developed a Code of Conduct for Public Pension Service Providers. Providers of professional services to public plans must be independent of conflicts in the same way trustees are. For that reason, NCPERS recommends that all public plan boards of trustees confirm, via a signed Code of Conduct, that their service providers are free from conflicts of interest arising from services provided to public defined benefit plans. The Code of Conflict was developed with the idea that it be provided, and signed by, not only all of the public plan's investment managers, but also their investment consultant, attorney, actuary, accountant, and custodian. Finally, the Code of Conduct was created to help public plan fiduciaries articulate strong, consistent ethical expectations for all of their service providers.

Attached herewith is the NCPERS memorandum to all public pension boards of trustees regarding the Code of Conduct, the Code of Conduct, and suggested Motion language if the Board wishes to adopt NCPERS's recommendation to have each of its service providers sign the Code of Conduct. **RECOMMENDATION:** consider adopting NCPERS Code of Conduct for Public Pension Service Providers.

- 2) The receipt date for the responses to the RFP for the Retirement Fund custodian was Friday, March 11, 2016. A resolution requesting a 90-day extension of the contract with Wells Fargo (taking the contract to June 30, 2016) will be presented for City Commission consideration at its March 16, 2016 meeting. **RECOMMENDATION:** Hold a special Board meeting as soon as possible to review and rank the RFP responses.
- 3) Please direct any question you have regarding the Pension Office and/or the Retirement Fund to me before seeking council from Jim Linn since questions posed directly to him incur fees the Fund must pay to his firm based on the amount of time Mr. Linn devotes to answering the question.

**RECOMMENDATION:**

For your information and discussion.



TO: Public Pension Boards of Trustees

FROM: NCPERS Executive Board of Directors

RE: Code of Conduct for Pension Service Providers- Fiduciary Analysis

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NCPERS has unveiled a code of conduct for vendors of public employee retirement plans. The providers of professional services to public pensions must be independent of conflicts in the same way trustees are. It is for this reason that NCPERS is recommending that all boards of trustees for public plans confirm with their service providers by having them execute a code of conduct that they are free from conflicts of interest that can arise with regard to services provided to defined benefit plans. NCPERS also recommends that the code of conduct be included as part of the request for proposal process when a plan is soliciting a service provider. The code of conduct was crafted so that it can be sent to not only investment managers, but all service providers to public plans, including investment consultants, attorneys, actuaries, and custodians. The code was created to help fiduciaries articulate strong, consistent ethical expectations for service providers across the board. This analysis is for the benefit of trustees when deciding whether to adopt the code of conduct for their plan. The intent is to arm trustees with the legal conclusion that it is part of their fiduciary duties to ensure that their professionals are free of conflicts of interest.

A person is a fiduciary with respect to an employee benefit plan to the extent he/she exercises discretionary authority with respect to the plan and its assets. Exercise of discretion is the key. As a general rule, fiduciary duties extend to attorneys, actuaries, accountants, investment management and consultants. The seminal decision in American jurisprudence on fiduciary duty is the decision of the New York Court of Appeals in *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928). In that case, the Court determined that the common standard of the marketplace is unacceptable to fiduciaries. Based on the ruling, the general trust standard was expanded for pension trustees to include a definition of "undivided loyalty" to be applied with "uncompromising rigidity." Much later, in *NLRB v. Amax Coal Co.*, 453 U.S. 322 (1981), the U.S. Supreme Court held that plan trustees have an "unwavering duty of complete loyalty" to members and beneficiaries. Trustees cannot serve any master other than the fund. Trustees of a retirement system have a fiduciary duty to insure the integrity of the System. *MaComb County v. AFSCME*, 294 Mich. 149, \_N.W.\_, 2011 WL 4374991 (Mich. App. 2011). The independence of the advice received and the actions taken by the fiduciaries in response is critical to accomplishing the high behavioral standards required by the law. *Board of Trustees v. City of Detroit*, 145 Mich. App. 651, 373 N.W.2d 173 (Mich. App. 1985). ERISA, although not applicable to governmental plans, codifies the duty of undivided loyalty to beneficiaries in several provisions, including the requirements that a plan fiduciary act "solely in the interest" of the plan and its participants and beneficiaries "for the exclusive purpose" of serving plan related goals. If a fiduciary takes action that he or she knows will harm a plan but will advance corporate or personal interests, that is a breach of the fiduciary duty to act "solely in the interest" of a plan.

In order for a plan's conflict of interest guidelines to be effective, trustees must have access to information that adequately describes service provider interests and relationships that could, at a minimum, give rise

to an appearance of impropriety. Trustees and staff should periodically affirm and verify compliance with conflict rules, regulatory reporting requirements, political contribution disclosures and other policies intended to protect the plan against the actuality or appearance of self-interested transactions and conflicts. Asking all service providers to sign a code of conduct helps fulfill this mission.

The responsibility for a trustee to be prudent covers a wide range of functions needed to operate a plan. Since you must carry out these functions in the same manner as a prudent person, it is in your best interest to consult experts in such fields as investments. What the courts refer to as prudence is actually a composite of separate duties of care, skill, prudence, and diligence. In general, the courts compare the conduct of a fiduciary to an objective standard of how a knowledgeable fiduciary would have acted under similar circumstances. Judicial decisions heavily emphasize the diligence component of the standard by examining whether and how the party considered issues that would be thought significant by a prudent fiduciary acting in similar circumstances. If a trustee cannot confirm that their outside plan experts are acting prudently and in the best interests of the plan, a case can be made that the trustee is not fulfilling his or her fiduciary responsibility to the plan.

In light of the clear legal standards, not only for the Board of Trustees, but for all of its advisors, it is essential that the Board ensure the exclusive duty of loyalty to the System is observed at all times and in all transactions. Trustees, in the usual course of plan business, should require all service providers to agree contractually that they are fiduciaries to the plan. The failure to have a provider agree that they are fiduciaries to the plan would allow them to skirt around the basic fiduciary considerations they owe to the plan. It is the duty of all fiduciaries to a retirement system to say "no" when any answer to the contrary is not in the best interest of the system. The code of conduct does not require a plan to fire a service provider should they not agree to execute the code. Merely, it should serve as a tool for trustees to identify and make informed decisions on behalf of their plan, and its members and beneficiaries should a conflict arise. NCPERS recommends that all boards of trustees of public retirement plans adopt use of the code of conduct to help promote the highest standards of ethics, education and professional excellence for the benefit of governmental defined benefit pension funds.

# **NATIONAL CONFERENCE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS**

## **CODE OF CONDUCT FOR PUBLIC PENSION SERVICE PROVIDERS**

Companies, firms, and other entities that provide services and products to public sector pension plans must:

1. Act in a professional and ethical manner at all times in dealings with public plan clients.
2. Act for the benefit of public plan clients.
3. Act with independence and objectivity.
4. Fully disclose to public plan clients conflicts of interest that arise that may impair the ability to act independently or objectively.
5. Act with reasonable care, skill, competence, and diligence when engaging in professional activities.
6. Communicate with public plan clients in a timely and accurate manner.
7. Uphold the applicable law, rules, and regulations governing your sector and profession.
8. Fully disclose to public plan clients all fees charged for the products or services provided to said client.
9. Not advocate for the diminishment of public defined benefit plans.
10. Fully disclose all contributions made to entities enumerated in Schedule A that advocate for the diminishment of public defined benefit plans.

# CERTIFICATION OF SERVICE PROVIDER

The undersigned acknowledges receipt of the NCPERS Code of Conduct for Public Pension Service Providers and certifies that it agrees to abide by the provisions of the Code.

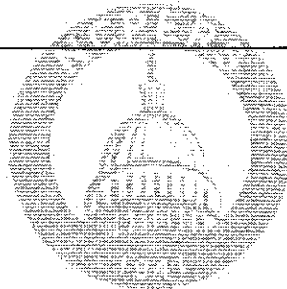
Signed: \_\_\_\_\_

Print Name: \_\_\_\_\_

Print Title: \_\_\_\_\_

Print Company: \_\_\_\_\_

Date: \_\_\_\_\_



*The Voice for Public Pensions*

Suggested motions to adopt and implement the NCPERS Code of Conduct for Public Pension Service Providers:

Motion 1: I move that \_\_\_\_\_

(insert name of public pension)

adopts the NCPERS Code of Conduct for Public Pension Service Providers and asks our current providers to endorse the Code of Conduct.

(Service providers can send the endorsed Code of Conduct to NCPERS by email to [codeofconduct@NCPERS.org](mailto:codeofconduct@NCPERS.org), fax to 202-624-1439, or mail to NCPERS, 444 N. Capitol St., NW, Suite 630, Washington, DC 20001)

Motion 2: I move that \_\_\_\_\_

(insert name of public pension)

incorporates the NCPERS Code of Conduct for Public Pension Service Providers as part of our service provider searches/request for proposals (RFP) process.

(Service providers can send the endorsed Code of Conduct to NCPERS by email to [codeofconduct@NCPERS.org](mailto:codeofconduct@NCPERS.org), fax to 202-624-1439, or mail to NCPERS, 444 N. Capitol St., NW, Suite 630, Washington, DC 20001)

Motion 3: I move that \_\_\_\_\_

(insert name of public pension)

notifies NCPERS of our decision to adopt the NCPERS Code of Conduct for Public Pension Service Providers.

(Public pensions can notify NCPERS by email to [codeofconduct@NCPERS.org](mailto:codeofconduct@NCPERS.org), fax to 202-624-1439, or mail to NCPERS, 444 N. Capitol St., NW, Suite 630, Washington, DC 20001)

## **AGENDA ITEM 11**

**NO BACKUP  
FOR THIS SECTION**